Q&A with Ginnie Mae's Ted Tozer

We asked Ginnie Mae President Ted Tozer about the critical changes being unveiled by Ginnie Mae as the issuer base shifts away from being mostly banks.

Mortgage Banking interviewed Ginnie Mae President Ted Tozer in September about the many changes that have taken place on his watch. Staffing has grown and so has issuance during his tenure. ¶ Ginnie Mae's outstanding mortgage-backed securities (MBS) volume has been rising steadily since 2008, and as of midyear was closing in on Freddie Mac's outstanding MBS total (see Figure 1). ¶ Long the quiet secondary market entity, Ginnie is making headlines of its own as non-depositories account for almost half of its issuance volume in fiscal year 2014 through July (see Figure 2). That share is up from just 17.7 percent in fiscal year 2010. ¶ Here's what Tozer had to say about many of the changes underway.

Q: *You currently have the longest tenure of any Ginnie Mae president. What is your proudest accomplishment and what do you still want to do?*

A: We've grown the staff from 60 people to nearly 120 in five years, and kept a steady course during one of the most trying times in the history of housing finance. Reaching the $1.5 trillion mark in MBS outstanding was a pivotal landmark—it signals that we are doing a lot of things right and that our model is scalable. But today's environment is vastly different than the one in which Ginnie Mae's model was originally conceived, and it has flourished.

The retreat of traditional banks and the subsequent rise of non-depositories in mortgage lending is creating the need for more complex oversight of entities that are not regulated for safety and soundness, as are traditional lenders.

As far as what I still want to accomplish, I want to make sure that the infrastructure is solid, and that Ginnie Mae's model can continue to be as successful as it has proven to be.

Q: *Does it matter that Ginnie Mae is still the lesser-known agency securitization?*

A: It matters in the sense that it's necessary to understand what Ginnie Mae does in order to understand what it takes to continue to be successful. If the goal is a remote-loss position, then the Ginnie Mae model works because it minimizes risk to taxpayers while providing a credit-risk-free security for investors. In the Ginnie Mae model, the first layer of loss absorption is the borrowers' equity—the same as in the GSEs [government-sponsored enterprises].

The second layer, for Ginnie Mae issuers, is the credit enhancement they have purchased from government agencies. The third layer of protection is the Ginnie Mae issuers themselves. Ginnie Mae is in the fourth-loss position with our explicit government guaranty. And Ginnie Mae has never been a GSE; it has always been a corporation wholly owned by the U.S. government.

Upholding the Ginnie Mae guaranty means that we are responsible for shepherding $1.5 trillion in debt service to the bond market. We operate a single security platform for 433 issuers—you can compare this to FHFA's [the Federal Housing Finance Agency's] exploration of a single security platform for two issuers, the GSEs.

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One of our biggest priorities is to oversee the issuers and make sure they can make their pass-through payments to the investors. So our monitoring must include a financial as well as an operational perspective.

Several factors are key to our success: the bifurcation of credit and interest-rate risk created by the explicit government guaranty; the ability to attract the lowest-cost funding for issuer/ lenders; and the value (fungibility) of our guaranty to global investors.

It's important to understand that global investors, who often buy or sell tens of millions of dollars of Ginnie Mae MBS at a time, are able to make these transactions because they don't have to worry about the quality of the underlying loans or the size of the lender, so this evens the playing field between all the originators that participate in our program.

Q: *Does the changing market change your position about Ginnie Mae's model?*

A: The Ginnie Mae program was not conceived, and does not operate, on making a distinction between banks and non-banks. However, the liquidity of our issuers has always been a paramount concern. While many of the new entities have ample capital, they generally don't have the liquidity of depositories. [We have a chart] showing just how much our issuer base has changed. And it also reflects the volume being handled by non-depositories [see Figure 2].

Servicing is also very important. We have 433 issuers who are responsible for making payments to the investor. If for some reason a servicer defaults, we have to transfer the servicing. If we have a good MSR [mortgage servicing rights] market, we can transfer the servicing from servicer A or B at no cost to the government. Our guaranty works because we can do that quickly and seamlessly with no cost to the investor. Our guaranty is only called upon if we cannot find a new servicer, which makes it unique.

Operational monitoring of non-banks that rely on networked arrangements is much more difficult because the financial capacity, origination capacity and servicing capacity are in separate locations. The core function of the primary financial institution is to manage and oversee the linkage of the separate pieces and ensure that the assembled functions, when assembled as a whole, work smoothly. Because of these "networked" structures, there is more room for breakdowns.

Q: *How has Ginnie Mae successfully evolved in the last five years?*

A: We've adapted by hiring more people and by working with our contractors to refocus them on the new areas of risk. We have revised our Acknowledgement Agreement to allow new issuers to pledge their Ginnie Mae servicing as lines of credit. We've tried to accelerate bringing on new issuers, particularly as the big aggregators have withdrawn.

However, our openness to supporting the transformation to non-bank servicers does not imply that we don't see the greater risks that this trend presents. As I mentioned previously, non-banks are not subject to the same regulations to which depositories are held. This means we must substantially change our counterparty and governing practices.

We've also increased staffing in our monitoring areas and strengthened our standards. Ginnie Mae is working to upgrade its ability to assess both the financial and operating capacity of its issuers, and the establishment of new measures and standards are likely.

Q: *What's your outlook for the market: Will banks return? Do we need them?*

A: It's clear that many of the bigger depositories have been evaluating the market in light of broader economic and regulatory developments, and increasingly, they've decided to decrease their activity for the foreseeable future. I think we're undergoing a long-term, structural change to the market in which many banks are replaced by this new breed of non-depository institutions.

Ginnie Mae's business model doesn't fundamentally rely on a distinction between banks and non-banks. However, there are concerns and we will need to make changes to adapt to the new environment.

While private equity has allowed some of the non-depositories to spring up rapidly and grow at rapid rates, that pattern is dependent on less-stable capital; it is not reliant on traditional relationships with customers or the community. Moreover, these non-depositories aren't regulated for safety and soundness—given they are not subject to FDIC [Federal Deposit Insurance Corporation] or OCC [Office of the Comptroller of the Currency] oversight. Ginnie Mae may have to play more of this role in the future.

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With banks leaving the market for the foreseeable future, Ginnie Mae is also concerned with maintaining and ensuring that credit is readily available. Part of this effort is helping community banks participate in the MBS market. A typical MBS needs to be so large that small lenders simply don't have the volume to participate. However, our Ginnie II securities are multi-issuer-based, which means that even the smallest lenders can compete on the same terms as the large national banks.

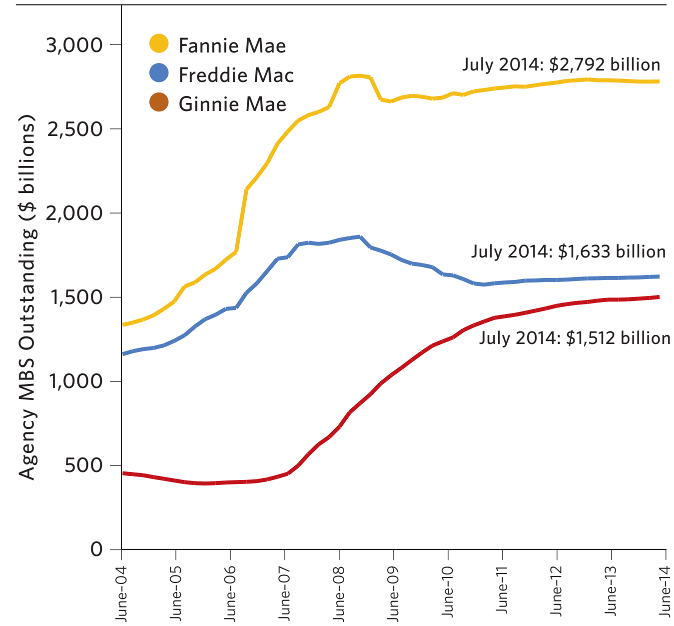
We are also rolling out a pilot program with the Federal Home Loan Bank of Chicago [FHLBC]. The new conduit program allows the FHLBC to issue securities guaranteed by Ginnie Mae, which will make it easier for FHLBC member banks to participate in our program and take advantage of its benefits.

Q: *What is the greatest challenge for Ginnie right now?*

A: There is no one greatest challenge. As our charter envisioned, and history has borne out, Ginnie Mae is a crucial cog in the wheel of America's mortgage finance system—so bringing that global capital into the market, while insuring that our securitization platform works for 433 issuers, means we are running a huge business.

FIGURE 1

GINNIE MAE OUTSTANDING MBS RELATIVE TO THE GSEs



SOURCES: Fannie Mae and Freddie Mac monthly reports, Ginnie Mae

NOTES: Data for Fannie, Freddie and Ginnie Mae available through July 2014. Ginnie Mae data includes HECMs.

We have been successful, returning a profit every year for the taxpayer. We have to do a better job communicating this and being clear about what it takes to be successful, and we're working on that.

We are adapting to a housing finance market that is evolving rapidly. Already it's different than anything we have ever seen before. It took us 40 years to get to $1 trillion in MBS outstanding; then from 2010 to 2014 we grew by half that volume, reaching $1.5 trillion. So first and foremost, we will need to significantly expand our staff to deal with this change. But equally important is that these complex new institutions will require Ginnie Mae to develop expertise in analyzing the structure of complex institutions that are still difficult to understand.

Q: *Can private-label securities replace Fannie Mae, Freddie Mac and Ginnie Mae?*

A: History suggests that [private-label securities (PLS)] will never replace Ginnie Mae or the GSEs. Even at the peak of the PLS market in the mid-2000s, PLS was only 20 percent of the market—far less than the share occupied by Ginnie, Fannie and Freddie. Ginnie Mae and the GSEs essentially replaced the savings-and-loan [S&L] industry after the S&L crisis in the 1980s, so we're a pretty established part of the market.

PLS also doesn't have a government guaranty, explicit or implicit, and that element is critical to attracting global capital.

Q: *What are the safeguards in place today that would help to prevent another Taylor, Bean & Whitaker fraud from occurring? What was learned from that experience?*

A: The Taylor, Bean & Whitaker fraud was a learning exercise for everyone at Ginnie Mae. Since then, we have established the first Office of Enterprise Risk; developed the capacity to sell defaulted portfolios contemporaneously with a default; implemented controls designed to detect selected risks such as those associated with the Taylor, Bean & Whitaker fraud; and implemented and enhanced several technology solutions designed to aggregate financial and performance data on issuers, including rating the likelihood of default. We also plan to announce new capital and liquidity requirements for our issuers.

However, as important as these enhancements are, by far the most important element in helping to detect another Taylor, Bean & Whitaker–like fraud is significantly increasing the number of staff charged with managing counterparty risk across all of our operations.

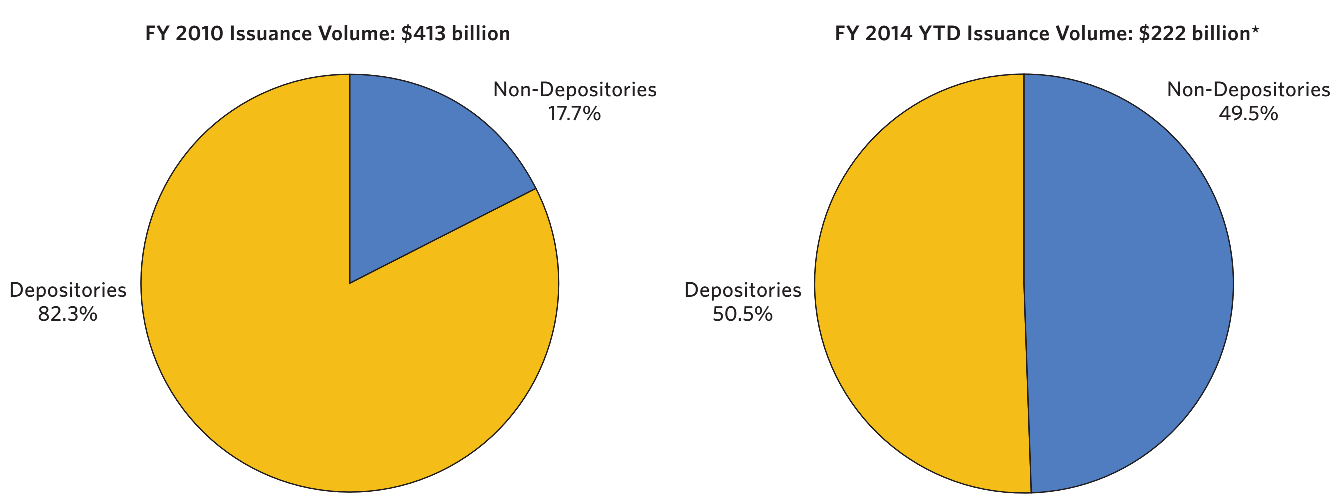
Q: *How has the decline in the overall homeownership rate affected volume in the Department of Veterans Affairs [VA], U.S. Department of Agriculture [USDA] and Federal Housing Administration [FHA] home loan programs? Many articles have been written about how younger generations prefer renting over owning. Have you seen evidence of that in the statistics you monitor?*

A: Ginnie Mae's MBS program exists to support those government programs, so trends in our new issuances reflect the programs' success. While FHA still makes up the largest share of our issuances, FHA's share has dropped significantly while VA loans have increased. What's happening is that veterans, who used to go to FHA and Fannie and Freddie, are finding that VA loans offer them a better deal.

For younger generations, the so-called millennials, many of them are simply putting off home purchases. It's difficult to parse that out in the data we monitor, but there has been a small overall drop in our issuance compared with where we were at last year. However, when these young people eventually buy, they're likely to go with FHA and, for those who are veterans, VA loans—and so Ginnie Mae still looks to be a dominant player in the MBS market in the upcoming years. **MB**

FIGURE 2

CHANGE IN COMPOSITION OF GINNIE MAE MBS ISSUER BASE



SOURCE: Ginnie Mae

NOTE: Ginnie Mae issuers are responsible for servicing the securities and the loans backing them; in the case an original Issuer sells servicing to another entity, the new entity takes on all obligations of the original issuer

* FY 2014 year-to-date (YTD) includes October 2013–July 2014 issuance